Editor's note: Appealed -- aff'd, sub nom. Enron Oil & Gas & Belco Petroleum Corp. v. Lujan, Civ.No. H-89-1411 (S.D. Tex. Sept. 16, 1991), 778 F.Supp. 348; aff'd, No. 91-6161 (5th Cir. Nov. 30, 1992), 978 F.2d 212, petition for cert filed No. 92-1726 (April 26, 1993); denied, Oct. 4, 1993, 114 S.Ct. 59

ENRON CORP.

IBLA 87-804 Decided January 23, 1989

Appeal from a decision of the Director, Minerals Management Service, denying appeals from orders to pay additional royalties and late payment charges. MMS-86-0399-O&G, MMS-86-0483-O&G.

Affirmed.

1. Oil and Gas Leases: Royalties

Where natural gas produced from Federal leases is sold under an arrangement where the buyers pay the maximum lawful price allowed under the Natural Gas Policy Act of 1978 and, in addition, reimburse the producer/seller for severance taxes it paid to the State of Wyoming, the gross proceeds received by the producer/seller from the leases consist of the maximum Natural Gas Policy Act price plus the tax reimbursements. Accordingly, in computing the "value" of the gas produced from these leases, MMS properly determines that the "gross proceeds" to which the royalty rate applies include the purchase price plus the tax reimbursements and properly demands additional royalty and late payment charges where royalty payments were made using a value that excluded the severance tax reimbursements.

APPEARANCES: Dante L. Zarlengo, Esq., Denver, Colorado, for appellant; Howard W. Chalker, Esq., Peter J. Schaumberg, Esq., and Geoffrey Heath, Esq., Office of the Solicitor, for the Minerals Management Service.

OPINION BY ADMINISTRATIVE JUDGE HUGHES

Enron Corporation (Enron) 1/ has appealed from the June 29, 1987, decision of the Director, Minerals Management Service (MMS) (MMS-86-0399-O&G

1/ These appeals were originally brought by Belco Petroleum Corporation, Belco Development Corporation, and Bel North Petroleum Corporation. Counsel for Enron states: "Enron Oil and Gas Company has succeeded by merger to the interest and liabilities, if any, of Belco Development Corporation, and Bel North Petroleum Corporation. Belco Petroleum Corporation and Enron Oil and Gas Company are both subsidiaries of Enron Corp." Counsel for Enron refers to all of these entities as "Enron." So shall we.

and MMS-86-0483-O&G), denying an appeal from three different orders requiring the payment of additional royalties and interest thereon for failure to include in the value of production reimbursements received by Enron from its customers for state severance taxes paid by Enron. 2/

The State of Wyoming (the State) imposes an ad valorem severance tax on the sale of gas production from wells within the State. By agreement with Enron, the purchasers of gas from the subject leases not only pay Enron the maximum lawful price allowed under the Natural Gas Policy Act of 1978 (NGPA), 15 U.S.C. || 3301-3422 (1982), but they also reimburse Enron for the severance tax. Thus, the total compensation Enron receives from its customers consists of the maximum lawful NGPA price plus the tax reimbursements. MMS determined that Enron was required to include the amount attributable to the reimbursement of severance tax in determining the gross proceeds of the lease to which the royalty rate was to be applied. Enron contends that the tax reimbursements must be excluded.

[1] Federal oil and gas lessees are required to pay a royalty of "12-1/2 per centum in amount or value of the production reserved or sold from the lease." 30 U.S.C. | 226(b) and (c) (1982). When royalty is not taken in kind, it is calculated as 12-1/2 percent of the value of produc-tion from the lease. The Mineral Lands Leasing Act of 1920, as amended, 30 U.S.C. | 181 (1982), reserves to the Department the authority and responsibility to establish reasonable value for royalty purposes. Marathon Oil Co. v. United States, 604 F. Supp. 1375, 1381 (D. Alaska 1985), aff'd, 794 F.2d 1461 (9th Cir. 1986); accord, California Co. v. Udall, 296 F.2d 384 (D.C. Cir. 1961); Continental Oil Co. v. United States, 184 F.2d 802 (9th Cir. 1950); United States v. Ohio Oil Co., 163 F.2d 633, 639-40 (10th Cir. 1947), cert. denied, 333 U.S. 833 (1948). Departmental rules for determining value for royalty purposes are set forth at 30 CFR 206.103 (formerly 30 CFR 221.47), which states:

> The value of production, for the purpose of computing royalty, shall be the estimated reasonable value of the product as determined by the Associate Director [of MMS,] due consideration being given to the highest price paid for a part or for a major-ity of production of like quality in the same field, to the price received by the lessee, to posted prices, and to other relevant matters. Under no circumstances shall the value of production of any of said substances for the purposes of computing royalty be deemed to be less than the gross proceeds accruing to the lessee from the sale thereof or less than the value computed on such

2/ The Director's decision denied appeals from three separate orders: (1) a May 7, 1986, order to pay $1,052,597.41 additional royalties on reimbursed state ad valorem severance taxes for gas produced on Federal onshore leases from 1977 through 1983; (2) an Aug. 19, 1986, order to pay $685,253.50 interest due on the royalties due under the May 7, 1986, order; and (3) a Sept. 2, 1986, order to pay royalty on reimbursed state ad valorem severance tax on gas production after 1983.

> reasonable unit value as shall have been determined by the Secretary. In the absence of good reason to the contrary, value computed on the basis of the highest price per barrel, thousand cubic feet, or gallon paid or offered at the time of production in a fair and open market for the major portion of like-quality oil, gas, or other products produced and sold from the field or area where the leased lands are situated will be considered to be a reasonable value. [Emphasis added.]

It has been well established for many years that severance tax reimbursements made by the buyer of gas produced from Federal wells to the Federal lessee/producer/seller are properly included as part of the gross value of the production in computation of the royalty due to the Government. Tricentrol United States, Inc., 105 IBLA 392 (1988); Amoco Production Co., 29 IBLA 234, 235 (1977); Wheless Drilling Co., 13 IBLA 21, 80 I.D. 599 (1973); see Hoover & Bracken Energies, Inc., 52 IBLA 27, 88 I.D. 7 (1981), aff'd, Hoover & Bracken Energies, Inc. v. U.S. Department of the Interior, 723 F.2d 1488 (10th Cir. 1983), cert. denied, 469 U.S. 821 (1984). 3/ The reasons for this rule are set out in Wheless, which presented circumstances virtually identical to those present here:

> It seems obvious to us that the buyer is paying to the seller an amount greater than the established field price for the natural gas it purchases from the * * * well. It follows, therefore, that it is reasonable to compute the Federal royalty of the natural gas taken from this well on a unit value consisting of the field price established by [the Federal Power Commission] plus the amount of the severance tax reimbursed by the buyer. Within the context of 30 CFR 221.47, "gross proceeds" means the established field price for the natural gas plus any additional sums paid by the producer of the gas to the unit operator as consideration for the purchase of gas from the unit of which the federal lease is a part.

13 IBLA at 30, 80 I.D. at 603. We also specifically held in Wheless that "gross proceeds" consisted of "the gas purchase price plus the reimbursed severance tax." 13 IBLA at 32, 80 I.D. at 604.

Since Wheless, the rule that gross proceeds shall include tax reimbursements has been widely disseminated. It was set out expressly more than 11 years ago in Notice to Lessees and Operators of Federal Onshore Oil and

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3/ In Hoover & Bracken Energies, Inc., supra, we considered a slightly different situation than that presented in this case. Under Oklahoma law, state severance tax must be paid by the buyer, rather than by the producer/ lessee/seller, as is the case in Wyoming. In Hoover, the buyer agreed both to pay the NGPA ceiling price and to pay the state severance tax. We ruled that, even though the obligation to pay under Oklahoma law rested with the buyer, its willingness to pay the severance tax in addition to the maximum NGPA price established a "value" for the gas equal to the actual price to the buyer, that is, the NGPA price plus the severance tax. 52 IBLA at 36, 88 I.D. at 12.

Gas Leases-1 (NTL-1), 42 FR 4546 (Jan. 25, 1977), which states in pertinent part:

> Under no circumstances will the royalty value be computed on less than the gross proceeds accruing to the operator from the sale of such leasehold production. Gross proceeds include, * * * tax reimbursements and payments to the operator for gathering, measuring, compressing, dehydrating, or performing other services necessary to market the production. [Emphasis added.]

The same rule was also published in NTL-5, 42 FR 22610, 22611 (May 4, 1977). While this appeal was pending, Congress enacted the Notice to Lessees Numbered 5 Gas Royalty Act of 1987, P.L. 100-234, 101 Stat. 1719 (1988). Although Congress modified one part of the NTL-5, it left intact, and thus effectively ratified, the requirement that tax reimbursements be included in calculating gross proceeds. 4/

Nevertheless, Enron contends that basing a royalty calculation on tax reimbursements is arbitrary, capricious, and an abuse of discretion. Enron suggests that Hoover & Bracken is not applicable because that case involved a communitization of several leases and "the court held in effect that the government's share of production was indistinguishable from every other royalty owner's share because of the communitization agreement." Enron contends that under Wyoming law "[a]s between landowners royalty and other portions of production from a well, the tax is calculated separately, assessed separately, and collected separately." This argument is unavailing. Under 30 CFR 206.103, the value of the Federal royalty gas can be no less per unit than the value of other gas of the same quality from the field. This requirement prevents the producer from assigning a lower value to the Federal royalty gas than to other gas having the same characteristics. The value of a unit of gas is what a buyer is willing to pay for it. Enron's customers are willing not only to pay the NGPA price but also pay the severance tax. Thus, the true value to Enron's customers for each unit of gas from the subject leases is the sum of the NGPA price and the tax reimbursements.

Enron, as Federal lessee/producer/seller could presumably have struck a bargain to sell the gas for the NGPA price alone, under which arrangement its payment of the state severance tax would effectively have reduced its

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4/ This legislation enacted a change in one requirement of NTL-5 with respect to production from 1982 to 1986 from certain wells. Under NTL-5, the base value for royalty purposes was either the actual price received or the ceiling price, whichever was higher. After 1982, actual gas prices in many areas declined below the ceiling price, but the lessees were still required to base the royalty on the ceiling price. The new statute provided that the value of production for certain leases between 1982 and 1986 would be based on the actual price received. This provision does not apply to this appeal.

proceeds from the sale. 5/ However, it was able to find a buyer which valued the gas highly enough to be willing to pay both the NGPA price and to reimburse it for its severance tax payments. As we noted in Hoover & Bracken Energies, Inc., 52 IBLA at 31, 88 I.D. at 11, sec. 110(a) of NGPA, 15 U.S.C. | 3320(a) (1982), expressly provides that a price for the first sale of natural gas will not be considered to exceed the maximum lawful price if the first sale price exceeds the maximum lawful price to the extent necessary to recover state severance taxes attributable to the production of such natural gas and borne by the seller. Thus, it was apparently permissible for Enron to increase its receipts by allowing its buyer to reimburse it for the state severance tax owed on the production. However, doing so increased the amount of the proceeds it received and, as a result, increased the amount of the royalty due to the United States.

Enron contends that the royalty valuation based upon tax reimbursements is contrary to the requirement of 30 CFR 206.103 that provides that royalty production be valued comparatively with other production of like quality. Enron maintains that Government production is materially different from other production from the same well because it is not subject to state taxation, so that the regulation requires comparative valuation to other tax-free production. Such a construction of the regulation is untenable because it defeats the regulation's purpose of ensuring that Federal gas having the same physical properties as other gas from the same field is not assigned a lower value. We have previously observed:

> The fact that the United States cannot be assessed state severance tax does not depreciate the value of the gas to it. Immunity from state taxation is a function of the Federal Government's sovereignty, which prevents the state from assessing a severance tax. This benefit flows to the Government, not the lessor.

Hoover & Bracken Energies, Inc., 52 IBLA at 37, 88 I.D. at 12, quoted with approval in Hoover & Bracken Energies, Inc. v. U.S. Department of the Interior, supra at 1491.

Finally, Enron argues that the valuation of production to include tax reimbursements violates the provisions of the NGPA. Enron contends that the Wheless Drilling Co. decision is no longer valid because the application of its analysis after passage of the NGPA would place the value of the Government's royalty share above the maximum lawful NGPA price. Enron misconceives the intent of the legislation and overstates its effect. The legislation affected the price that producers could charge their customer, but Enron cites no language in the Act or its legislative history indicating that Congress intended to change any existing royalty obligations between

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5/ Enron's statement of reasons suggests that the reimbursement of state severance tax payments by a purchaser is negotiable: "Some gas purchase agreements require the purchaser to reimburse Enron for ad valorem taxes." Presumably, other agreements do not.

the lessees and the Government. Congress has specifically addressed such matters when it perceived that a change was needed. E.g., NTL-5 Gas Royalty Act of 1987, supra. The court's Hoover decision rejected arguments similar to Enron's and held: "The recent enactment of the NGPA does not affect the soundness of the reasoning present in Wheless." 723 F.2d at 1493.

Enron offers no specific reasons that MMS' imposition of late payment charges was incorrect. However, it would follow that late payment charges would not be due if it were not required to pay the royalty in the first place. Inasmuch as we have held that Enron was properly required to pay the additional royalty, MMS' decision requiring it to pay late payment charges must also be affirmed.

Therefore, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decision appealed from is affirmed.

David L. Hughes
Administrative Judge

I concur:

Kathryn A. Lynn
Administrative Judge
Alternate Member